

**DRAFT**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**  
**ENERGY DIVISION**  
Item 35 ID#4225  
**RESOLUTION E-3896**  
**JANUARY 27, 2005**

**R E S O L U T I O N**

Resolution E-3896. San Diego Gas & Electric Company (SDG&E) for approval of: (1) the contract with Ramco to acquire a 46 MW combustion turbine (CT) and related equipment as approved by the Commission in D.04-06-011; (2) an exemption from Public Utilities (PU) Code Section 851, as permitted by PU Code Section 853, for Commission approval of the temporary transfer of a portion of SDG&E's Miramar property to Ramco for the purpose of siting its CT; (3) SDG&E's first year revenue requirement for ownership and operation of the Ramco CT; and (4) an annual update mechanism for the Ramco CT that will be in place until SDG&E's next general rate case/cost of service proceeding.

By Advice Letter 1621-E, filed on September 8, 2004.

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**SUMMARY**

**In Advice Letter (AL) 1621-E, which was filed in compliance with Ordering Paragraph #8 of Decision (D.) 04-06-011, San Diego Gas & Electric Company (SDG&E) requested that the Commission approve its contract with Ramco, adopt its ratemaking proposal, and grant an exemption from Public Utilities Code Section 851 analysis and review regarding a temporary land transfer. This resolution approves the contract and the ratemaking proposal, albeit at SDG&E's current return on equity (ROE) rather than the ROE in effect when SDG&E filed its advice letter. The Section 851 matter is now moot, since it was already decided by the Commission in D.04-10-030.**

Ordering Paragraph #8 of D.04-06-011 directed SDG&E to file advice letters, or tariffs, as appropriate and necessary to implement the orders, conclusions, and results reached in that decision regarding SDG&E's Grid Reliability Request for Proposal (RFP).

SDG&E requests that the Commission:

1. approve the contract (Turnkey Acquisition Agreement) between SDG&E and Ramco;
2. grant the utility an exemption from Public Utilities Code Section 851 analysis and review for the temporary Miramar land transfer, pursuant to Section 853(b);
3. adopt its request for the first year revenue requirement for ownership and operation of the Ramco CT; and
4. adopt its request for the annual update mechanism for its first year revenue requirement, pending the next general rate case/cost of service proceeding.

This resolution approves items 1, 3, and 4 (as described above) of AL 1621-E, effective today. Item 2 is now moot, as the Section 851 issue was addressed by SDG&E in A.04-10-009 and decided by the Commission in D.04-10-030.

## **BACKGROUND**

**AL 1621-E was filed in compliance with Ordering Paragraph (OP) #8 of D.04-06-011. In that decision, the Commission approved five proposals that SDG&E presented to meet its short- and long-term grid reliability needs. One of the proposals was a Term Sheet between SDG&E and Ramco, a turnkey proposal whereby Ramco would construct a 45 MW combustion turbine (CT) and related equipment. SDG&E intends to acquire title and initiate operation of the CT for its load requirements beginning June 2005.**

On June 9, 2004, the Commission issued D.04-06-011. In that decision, the Commission approved the Term Sheet between SDG&E and Ramco, where Ramco agreed to design, permit, and construct a 45 MW CT in Chula Vista, California. The Commission found that the Ramco CT acquisition was supported by the record, and stated, "We approve the terms and conditions in the Term Sheet ... and we will approve it [the contract] when it is submitted to the Commission. However, we do not approve the cost recovery, ratemaking, and revenue requirement proposals as presented by SDG&E at this time"<sup>1</sup>

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1. D.04-06-011, page 41.

Ordering Paragraph #8 of D.04-06-011 directed SDG&E to file advice letters, or tariffs, as appropriate and necessary to implement the orders, conclusions, and results reached in that decision regarding SDG&E's Grid Reliability RFP.

In AL 1621-E, SDG&E submits the SDG&E/Ramco turnkey contract (Turnkey Acquisition Agreement) for final approval, and requests approval of associated cost recovery and ratemaking mechanisms. The advice letter, and the authorization requested, is filed as required by, and pursuant to, Ordering Paragraphs 5 and 8 of D.04-06-011.

Portions of Attachments 1 (the contract) and 3 (adjustments made in pricing and contract scope) to AL 1621-E include information that SDG&E asserts is confidential, and protected from disclosure under the provisions of PU Code Section 583 and the Commission's General Order (GO) 66-C. The confidential (unredacted) portions of those Attachments were submitted to the Commission only. PU Code Section 583 prohibits disclosure of confidential public utility information except by Commission order or in the course of a hearing or proceeding.

The elevation difference due to the project's site change (from Chula Vista to Miramar) and more refined estimates in the final design increased the expected output by roughly 510 kW. Hence, the 45 MW project is now a 45.51 MW project, or, with rounding, up to 46 MW.

SDG&E noted that it had provided a draft of this advice letter to The Utility Reform Network (TURN) and solicited their comments. SDG&E says it made various changes to the advice letter based on TURN's input.

## **NOTICE**

Notice of Advice Letter 1621-E was made by publication in the Commission's Daily Calendar. SDG&E states that a redacted copy of the Advice Letter was served on the utilities and interested parties, and hence distributed in accordance with Section III-G of General Order 96-A.

## **PROTESTS**

Advice Letter AL 1621-E was not protested.

## **DISCUSSION**

**The specific Commission approvals requested by SDG&E are: (a) the contract between Ramco and SDG&E; (b) an exemption from PU Code Section 851 of the Miramar land transfer pursuant to PU Code Section 853; (c) SDG&E's first year revenue requirement for ownership and operation of the CT; and (d) the annual update mechanism for SDG&E's first year revenue requirement pending the next general rate case/cost of service proceeding.**

**A. The contract between Ramco and SDG&E is different from the Term Sheet which the Commission approved in D.04-06-011, because various adjustments were made in pricing and scope during negotiations between the two parties.**

After SDG&E submitted the Term Sheet for Commission approval in its RFP Motion on October 7, 2003, SDG&E and Ramco continued to negotiate the contractual documents to implement the intent of the parties as specified in the Term Sheet. The negotiations between SDG&E and Ramco resulted in the Turnkey Acquisition Agreement ("Agreement"), which SDG&E included as Attachment 1 to AL 1621-E. SDG&E asserts that the Agreement is in substantial conformance with the Term Sheet, although in the negotiations there were various adjustments made in pricing and contract scope. Essentially, the final negotiated price for the Ramco CT increased by \$658,000, from \$30.8 million (the price in the Term Sheet) to \$31.458 million, or a 2.1% price increase.<sup>2</sup>

The majority of this cost increase is due to an adjustment for tax consequences and the increased cost of the CT. A summary of the material cost changes is as follows:

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2. This price is subject to further adjustment, as set forth in the Turnkey Acquisition Agreement. One such adjustment could be an increase in Ramco interest costs, currently estimated to be \$642,000; if this were added to the base purchase price, it would increase to \$32.1 million. SDG&E also informed Energy Division that costs could increase by another \$700,000 due to legal fees and engineering change orders, primarily driven by the site change. SDG&E intends to file an advice letter prior to the in-service date to true up the base purchase price for such adjustments.

- The price was increased by \$675,000 based upon the further evaluation of tax consequences to each party resulting from the sale of the facilities as assets rather than through the transfer of stock (equity transaction).
- The price was increased by \$300,000 based upon the need to begin permitting at the second (Miramar) site, to ensure a June 2005 in-service date.
- Final negotiations with General Electric (GE) resulted in a 3% net increase in price over initial estimates for the generator package.
- The price was lowered by \$300,000 to adjust for refinements made by GE in its latest version of the CT that reduced Ramco's facility completion costs.
- The price was reduced by \$750,000 to reflect the savings in land cost by construction of the facility on the Miramar site as opposed to the Chula Vista site.
- The price was increased by \$200,000 to compensate Ramco for additional services it provided in the negotiations with GE over the price and attributes of the CT.

A summary of the material changes to commercial terms is as follows:

- The requirement that Ramco's debt/equity ratio be no greater than 80% debt to 20% equity was limited to the project cost exclusive of the cost of the generator package.
- The performance bond requirements were reduced from \$8.0 million to \$4.0 million.<sup>3</sup>
- SDG&E agreed to increase its share of pre-payments. The most significant change is SDG&E's agreement to make a secured down payment to GE. The negotiated down payment saves SDG&E approximately \$200,000 in interest over the payment schedule proposed by GE.
- The cure period for Ramco to meet final completion, after meeting minimum acceptance criteria, was extended from 3 months to 6 months.

***Energy Division recommends that the Commission approve the contract (Turnkey Acquisition Agreement) between SDG&E and Ramco.***

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3. The bond ensures that funds would be available to finish the plant if the contractor fails to perform and SDG&E is forced to step in.

OP #5 of D.04-06-011 states, in part, “SDG&E may execute a contract with Ramco, that is consistent with the terms and conditions set forth in the Ramco Term Sheet...” (emphasis added) The Turnkey Acquisition Agreement between SDG&E and Ramco is not exactly the same as the Term Sheet which the Commission approved in D.04-06-011, but is still consistent with the price, terms, and conditions of the Term Sheet. Hence, Energy Division recommends that the Commission approve the contract between SDG&E and Ramco.

D.04-06-011 also noted that: (a) SDG&E needs to use this facility for intermediate load requirements beginning in June 2005; (b) the CT will help SDG&E meet its grid reliability needs; and (c) no party opposed the acquisition of the Ramco turnkey proposal. None of these facts or conditions has changed, and this project will help to meet SDG&E’s Summer 2005 reliability needs.

**B. In the advice letter, SDG&E requested an exemption from PU Code Section 851 of the Miramar land transfer pursuant to PU Code Section 853. That request was driven by the site relocation of the project, from Chula Vista to SDG&E’s Miramar property. This has already been addressed by the Commission in D.04-10-030.**

The Commission has already addressed this Section 851 matter in D.04-10-030. The issue is no longer relevant to AL 1621-E nor this resolution.

**C. SDG&E requests Commission approval of its proposed first year revenue requirement for ownership and operation of the CT, which includes a monthly fixed cost revenue requirement and a variable O&M component.**

SDG&E requests Commission approval, effective as of the date the Ramco CT is put in service, of both the monthly fixed cost revenue requirement of \$520,100 (subject to adjustment via advice letter filing) and the variable operating and maintenance (O&M) non-fuel rate of \$5.76/MWh. The monthly fixed cost revenue requirement will be recorded in SDG&E’s Non-Fuel Generation Balancing Account (NGBA) for recovery through SDG&E’s commodity rates

(Schedule EECC), as will the monthly variable O&M non-fuel costs.<sup>4</sup> The actual fuel costs of the Ramco CT will be recorded in SDG&E's Energy Resource Recovery Account (ERRA), and will also be recovered through SDG&E's commodity rates.

The monthly revenue requirement consists of a return on the rate base<sup>5</sup>, depreciation, taxes, fixed O&M expenses, and franchise fees & uncollectibles (FF&U). Ramco's rate base consists of: (a) the base purchase price for the facility (as adjusted); (b) Miramar site preparation costs; (c) general plant; (d) materials and supplies; (e) working cash; (f) mobilization costs; (g) transaction and legal costs; (h) sales and transfer taxes; (i) natural gas and backfeed power for start-up testing; and (j) accumulated depreciation and deferred taxes.

The Agreement specifies a base purchase price for the Ramco CT and associated equipment at \$31.458 million<sup>6</sup> that, after adjustment for estimated Ramco accrued interest costs of \$642,000, is adjusted to \$32.100 million. However, as also specified in the Agreement, this adjusted rate base is subject to further adjustments including, but not limited to, delay rebates and performance shortfall rebates, performance bonuses, change orders, the cost of spare parts, and a change in the site requiring a change in associated site costs. SDG&E says it will file an advice letter prior to the in-service date of the Ramco CT to true up the base purchase price for these adjustments.

Reliability costs of the Ramco CT will be recovered through the Reliability Services (RS) rate component that all SDG&E customers pay as part of their distribution rate, with the revenues collected being used to offset the cost of the

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4. The monthly variable O&M non-fuel costs will be calculated by multiplying the variable O&M non-fuel rate by the forecasted monthly generation output (MWh).
  5. In OP #5 of D.04-06-011, SDG&E was authorized to recover the Ramco investment at its then-effective authorized return on equity (ROE) for distribution operations of 10.90%. We note that SDG&E's current ROE is 10.37%, and SDG&E should be applying that lower ROE to its calculations.
  6. This is calculated by adding \$30.608 million for the plant assets to \$1.600 million for the substation equipment installed to support the CT, less the \$750,000 cost savings for siting the CT at SDG&E's Miramar site.

generation facility recovered in commodity rates. The amount to be recovered through the RS rate component will be determined by the RMR contract for Ramco, which is to be filed at FERC in March of 2005.

***Energy Division has determined that SDG&E's proposal for the first year revenue requirement for ownership and operation of the Ramco CT is reasonable, and recommends that the Commission adopt SDG&E's request.***

When SDG&E files the advice letter—prior to the in-service date of the Ramco CT—to true-up the base purchase price, it should include detailed supporting documentation showing that the base purchase price adjustments are consistent with the provisions of the Purchase Agreement approved in this resolution. At that time, SDG&E should also incorporate the currently applicable ROE of 10.37%.

**D. SDG&E requests Commission approval of its proposed annual update mechanism for SDG&E's first year revenue requirement pending the next general rate case (GRC)/cost of service (COS) proceeding.**

SDG&E's proposed regulatory/ratemaking framework (see Attachment 6 of AL 1621-E) for the revenue requirement associated with the Ramco CT consists of three phases: (a) an initial phase from the in-service date through the first full calendar year of operation (expected to be the year 2006); (b) a second phase consisting of additional years of operation until implementation of SDG&E's next GRC/COS decision (anticipated to occur in 2009); and (c) the term of the next GRC/COS.

The first phase revenue requirement would be determined as described above. The second phase would allow for annual attrition adjustments to the authorized first phase revenue requirement. The annual attrition adjustments would apply to O&M, capital, and financial element costs (such as any changes in the cost of capital). The third phase would begin upon issuance of a decision in a future GRC/COS that is subsequent to SDG&E's current COS proceeding, A.02-12-028.

***Energy Division has determined that SDG&E's proposal for the annual update mechanism for its first year revenue requirement, pending the next GRC/COS, is reasonable, and recommends that the Commission adopt SDG&E's request.***



The overall mechanics of SDG&E's ratemaking proposal regarding the first year revenue requirement and annual update mechanism for the Ramco CT is consistent with D.04-12-048.

## **COMMENTS**

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(3) provides that this 30-day period may be reduced/waived by Commission adopted rule.

The 30-day comment period has been reduced by a decision where the Commission has determined that public necessity, as defined in Rule 77.7(f)(9), requires reduction/waiver of the 30-day period.

We balance the public interest in ensuring that the Agreement is in place to provide grid reliability to SDG&E's customers—particularly for SDG&E's Summer 2005 concerns—against the public interest in having a full 30-day comment period. The public necessity in this case is that we need to ensure that the Ramco CT is operational in time to meet SDG&E's Summer 2005 capacity needs; a delay in approval of the Agreement has the potential to unnecessarily compromise the completion of the project. We find that a reduced review and comment period balances the need for public with the need for timely action on SDG&E's advice letter.

Pursuant to Public Utilities Code Section 311(g)(3) and Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, we reduce the public review and comment period to seven days for opening comments and three days for reply comments. Hence, comments were due on January 18, 2005, and reply comments were due on January 21, 2005.

## **TURN, the Independent Energy Producers Association (IEP), and SDG&E filed timely comments.**

TURN's timely-filed comments focus on how this resolution should reduce the return on equity (ROE) for the Ramco CT from 10.90% to 10.37%, consistent with

the Market Indexed Capital Adjustment Mechanism (MICAM) ROE reduction approved by the Commission in SDG&E's Advice 1630-E/1479-G.

TURN points out that Conclusion of Law #6 of D.04-06-011 indicates that the 10.90% is applicable "until modified by further action of the Commission," and argues that approval of the MICAM-triggered reduction in SDG&E's ROE constitutes the type of "further action of the Commission" contemplated by D.04-06-011.

IEP's timely filed comments focus on how our treatment of the Ramco project is inconsistent with D.04-12-048, because: (1) it was not the result of an open, transparent and competitive bidding process; and (2) the proposed ratemaking treatment for Ramco allows for future adjustments to the base purchase price and does not cap the utility's recovery of initial capital costs at the final bid price.

However, IEP does say that it "is not rearguing the Commission's decision approving the Ramco contract and ... does not dispute the ratemaking mechanisms that SDG&E proposes in its advice letter." At a minimum, IEP wants the resolution to correct the statement regarding how the proposed ratemaking treatment is consistent with D.04-12-048.

In its timely filed comments, SDG&E proposes two revisions to the draft resolution. First, SDG&E suggests language clarifying how certain costs will be recovered through the RS rate component. Second, SDG&E: (a) suggests language clarifying the type of supporting documentation that should be filed in a base price adjustment true-up advice letter prior to the in-service date; and (b) proposes that SDG&E file a second base price adjustment true-up advice letter not more than 90 days after the Ramco in-service date, since not all of the final costs pertinent to the final base purchase price may actually be known until after the Ramco CT is placed into service.

### **SDG&E filed timely reply comments.**

SDG&E states "TURN is correct that SDG&E's return on equity ("ROE") was reduced from 10.9% to 10.37% pursuant to AL 1630-E/1479-G after SDG&E filed Advice Letter 1621-E. Therefore, the fixed monthly revenue requirement proposed in Advice Letter 1621-E ... should be revised to reflect SDG&E's current ROE."

SDG&E takes issue with IEP's comments, and discusses how the Ramco Term Sheet conditions, incorporated into the contract and previously approved by the Commission, "allow SDG&E to recover not only the initial base purchase price but also additional costs resulting from various contractually-permitted adjustments for change orders, delay rebates and performance shortfall rebates, performance bonuses, the cost of spare parts, and other articulated costs." SDG&E goes on to defend the merits of its Grid Reliability RFP, and discusses how its acquisition of the Ramco CT was approved by the Commission before D.04-12-048 was issued, therefore, the requirements for all-source solicitations in D.04-12-048 should not be applied retroactively to Ramco.

**Energy Division has reviewed the comments and reply comments.**

We agree with TURN's suggestion regarding the matter of SDG&E's ROE. This resolution now reflects how SDG&E's current ROE of 10.37% should be the authorized ROE for the Ramco CT.

Regarding IEP's comments, we note that SDG&E's turnkey agreement with Ramco, which includes adjustments to the base purchase price to be reviewed at a later date, was previously approved by the Commission in D.04-06-011. We will not impose the cost cap as discussed in D.04-12-048 to the Ramco project. We also note that the overall mechanics of SDG&E's ratemaking proposal regarding the first year revenue requirement and annual update mechanism for the Ramco CT is consistent with D.04-12-048.

We agree with SDG&E's suggestion about adding language that clarifies cost recovery via the RS component, and have done so on page 8 of this resolution. We agree with SDG&E's suggestion about adding language that clarifies the type of supporting documentation that should be filed in the base price adjustment true-up advice letter that is to be filed prior to the Ramco CT's in-service date, and have done so on page 8 of this resolution.

We do not agree with SDG&E's proposal to file a second base price adjustment true-up advice letter after the Ramco CT's in-service date. Instead, SDG&E should address the need for a post in-service date true-up advice letter when it files the pre in-service date true-up advice letter.

We have addressed the matters discussed in the reply comments within this resolution.

## **FINDINGS**

1. Ordering Paragraph #8 of D.04-06-011 directed SDG&E to file advice letters, or tariffs, as appropriate and necessary to implement the orders, conclusions, and results reached in that decision regarding SDG&E's Grid Reliability RFP.
2. SDG&E filed Advice Letter 1621-E, in compliance with OP #8 of D.04-06-011.
3. Portions of Attachments 1 and 3 to Advice Letter 1621-E includes information that SDG&E asserts is confidential, and protected from disclosure under the provisions of PU Code Section 583 and the Commission's General Order (GO) 66-C.
4. Advice Letter 1621-E was not protested.
5. The Turnkey Acquisition Agreement between SDG&E and Ramco is not exactly the same as the Term Sheet, which the Commission approved in D.04-06-011, but is still consistent with the price, terms, and conditions of the Term Sheet.
6. D.04-10-030 already addresses the Section 851 issues in AL 1621-E.
7. The overall mechanics of SDG&E's ratemaking proposal regarding the first year revenue requirement and annual update mechanism for the Ramco CT is consistent with D.04-12-048.
8. In this case, public necessity warranted providing for a comment period of less than 30 days.
9. TURN, IEP and SDG&E submitted timely comments.
10. SDG&E submitted timely reply comments.
11. The Commission reduced SDG&E's ROE from 10.90% to 10.37% when it approved the Market Indexed Capital Adjustment Mechanism (MICAM) in SDG&E's Advice 1630-E/1479-G.

12. SDG&E is required to use its current ROE of 10.37% for the Ramco CT revenue requirement calculation rather than the then-effective ROE of 10.90% identified in AL 1621-E.

**THEREFORE IT IS ORDERED THAT:**

1. The Commission grants SDG&E's request for approval of: (a) the contract with Ramco to acquire a 46 MW combustion turbine (CT) and related equipment as approved by the Commission in D.04-06-011; (b) SDG&E's first year revenue requirement for ownership and operation of the Ramco CT; and (c) an annual update mechanism for the Ramco CT that will be in place until SDG&E's next general rate case/cost of service proceeding.
2. SDG&E's request for an exemption from Public Utilities Code Section 851, as permitted by PU Code Section 853(b), for Commission approval of the temporary transfer of a portion of SDG&E's Miramar property to Ramco for the purposes of siting its Combustion Turbine (CT) is moot. The Commission has already decided this matter in D.04-10-030, and does not have to be resolved in this resolution.
3. In order to be consistent with the Market Indexed Capital Adjustment Mechanism (MICAM) return on equity (ROE) reduction approved by the Commission in SDG&E's Advice 1630-E/1479-G, SDG&E is required to use its current ROE of 10.37% for the Ramco CT revenue requirement calculation rather than the 10.90% ROE proposed in AL 1621-E.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on January 27, 2005; the following Commissioners voting favorably thereon:

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STEVE LARSON  
Executive Director